LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

301 State House
(317) 232-9855

FISCAL IMPACT STATEMENT

LS 6507 **DATE PREPARED:** Feb 27, 2002
BILL NUMBER: HB 1004 **BILL AMENDED:** Feb 27, 2002

SUBJECT: State and Local Fiscal Matters.

FISCAL ANALYST: Diane Powers; Alan Gossard
PHONE NUMBER: 232-9853; 233-3546

FUNDS AFFECTED: X **GENERAL**
X **DEDICATED**
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) *State Spending Cap:* This bill establishes a state spending cap.

Rural Development Administration Fund: The bill also establishes the Rural Development Administration Fund.

Riverboat Admissions and Wagering Tax Provisions: The bill increases the Riverboat Admissions Tax to $4 and the Riverboat Wagering Tax rate to 22.5%.

Property Tax Provisions:

Assessment Rules: The bill voids the Department of Local Government Finance rule for the assessment of personal property scheduled to take effect March 1, 2002, and reinstates the previous rule. The bill also provides that the Department of Local Government Finance rule for the assessment of real property beginning March 1, 2002, is void to the extent that it includes a shelter allowance for residential property.

Homestead Deduction: The bill increases the standard homestead deduction from $6,000 to $25,000.

AV Growth Quotient: The bill changes the formula for determining the assessed value growth quotient for civil units and for school transportation funds.

Homestead Credit: The bill applies the Homestead Credit after the application of the state Property Tax Replacement Credit (PTRC) and provides that the replacement credit does not apply to taxes on business personal property. The bill maintains the amount of the Homestead Credit at 10% (instead of decreasing to 4%).

Property Tax Replacement Credit: It also increases the PTRC for general school operating levies to 100% and for other levies on real property to 39% and 20% for a public utility company. It also provides for refunds of property taxes paid on business personal property other than a public utility company.

Other Tax Provisions: The bill also establishes a Business Supplemental Tax. The bill also increases the Sales Tax rate to 6%, the individual Adjusted Gross Income Tax rate to 3.6%, and the corporate rate to 8.5%. The bill increases the Cigarette Tax rate to 55 cents per pack. It also establishes an Employer Payroll Expense Tax. It also increases the amount of the Research Expense Tax Credit from 5% to 10%, eliminates the apportionment factor for the credit, and extends the expiration date of the credit. This bill also increases the income limit on eligibility for the Earned Income Tax Credit from $12,000 to $15,000 and extends the expiration date of the credit. The bill repeals certain provisions related to the: (1) distribution of Adjusted Gross Income Tax revenues, (2) Supplemental Net Income Tax, and (3) Bank Tax, Production Credit Association Tax, and Savings and Loan Association Tax.

Medicaid Provisions: This bill eliminates chiropractic services for Medicaid children recipients under 19 years of age. The bill allows the Office of Medicaid Policy and Planning (OMPP) to limit: (1) chiropractic services for adult Medicaid recipients; and (2) the amount spent, except for preventive care services, on dental services for Medicaid recipients. The bill authorizes OMPP to require a Medicaid recipient to select one pharmacy. This bill also authorizes emergency filling of a 72-hour supply of a prescription at a pharmacy other than the pharmacy selected by the Medicaid recipient. The bill eliminates continuous eligibility for children under the Children's Health Insurance Program (CHIP) and includes financial eligibility.

The bill excludes aged, blind, and disabled recipients in certain locations from mandatory participation in Medicaid's Risk-Based Managed Care program. The bill also eliminates chiropractic services for children under CHIP. The bill also requires OMPP to implement measures to reduce state General Fund Medicaid expenditures by $250,000,000 from July 1, 2001, through June 30, 2003. It also requires OMPP to apply for a waiver to amend the state Medicaid plan to include the aged, blind, and disabled in the state's Medicaid managed care program.

School Provisions: The bill authorizes a school corporation to make certain transfers to its general fund from its capital projects fund. It also adjusts the calendar year caps for tuition support.

Muscatatuck State Developmental Center: The bill establishes a study committee concerning Muscatatuck State Developmental Center residents and employees.

State Budget Provisions: The bill revises certain appropriations and authorizes transfers from certain dedicated funds to the state General Fund.

School Referendum Tax Levies: This bill provides that if an excessive levy referendum is approved, a school corporation may impose a referendum tax levy that is separate from the general fund tax levy. It provides that voters may reimpose or extend a referendum tax levy through the referendum process but may not approve a referendum tax levy that is imposed for more than seven years. The bill provides that if the majority of voters in a referendum to allow a school corporation to impose a referendum tax levy did not vote to approve the levy, another referendum to impose a referendum tax levy may not be held for a period of one year. It does not include the referendum tax levy in the determination of state tuition support or maximum general fund tax levy. It also provides that a levy increase due to the imposition of a referendum tax levy is not eligible for property tax replacement credits.

Effective Date: (Amended) January 1, 2002 (retroactive); Upon passage; July 1, 2002; August 1, 2002; January 1, 2003; February 1, 2003; July 1, 2003.

Explanation of State Expenditures: (Revised)

***Summary* — Tax Restructuring Provisions:** This bill contains several provisions that impact state expenditures and revenues. There is a net increase in estimated expenditures of $838.6 M in FY 2003, $2,361.9 M in FY 2004, and $2,499.7 M in FY 2005. Estimated net revenue increases total $1,114.0 M in FY 2003, $2,254.5 M in FY 2004, and $2,314.1 M in FY 2005. The fiscal impact of each provision is summarized in the table below.

Net Expenditure and Revenue Impacts -- Tax Restructuring Provisions			
Provision	**FY 2003**	**FY 2004**	**FY 2005**
State Expenditures:			
Bus. Pers. Prop. Tax Refund (Non Utility) - 75%		$584.6 M	$596.3 M
Homestead Credit- 10%	(42.7 M)	(8.7 M)	70.1 M
PTRC (Real Prop, Non-Bus PP)- 39% (20% Util.)	(7.3 M)	(14.8 M)	(15.1 M)
School General Fund PTRF Credits *	889.1 M	1,802.2 M	$1,850.9 M
School Transportation Levy PTRC Savings	(.5 M)	(1.4 M)	(2.5 M)
Total Change in Expenditures	$838.6 M	$2,361.9 M	$2,499.7 M
State Revenues:			
Business Supplemental Tax - 1% (min $400)	$63.4 M	$160.5 M	$165.3 M
Cigarette Tax Increase - add $.395	262.8 M	287.4 M	288.8 M
Elimination of SNIT/Increase Corp AGI	37.9 M	80.0 M	84.4 M
Employer Payroll Expense Tax - 0.75%	276.0 M	561.4 M	580.5 M
Earned Income Tax Credit- $15,000 cap	(6.0 M)	(14.3 M)	(14.3 M)
Individual AGI - add .2%	87.4 M	234.6 M	242.6 M
$37,500 AV Credit Repealed		96.0 M	97.9 M
Research Expense Credit- add 5%/ No Appor.	(23.0 M)	(47.9 M)	(51.5 M)
Riverboat Admission Tax - add $1	41.7 M	42.5 M	43.4 M
Riverboat Wagering Tax - 22.5% on all AGR	46.3 M	47.9 M	49.6 M
Sales Tax - add 1%	327.5 M	806.4 M	827.4 M
Total Change in Revenues	$1,114.0 M	$2,254.5 M	$2,314.1 M
* Expenditure growth rates reflect the current revenue forecast and not the historical increases in these expenditures. Growth rates could be higher depending on future appropriations.			

***Summary* — Budget Deficit Reduction Provisions:** This bill contains several provisions which result in a positive impact on the state General Fund estimated to be $413.76 M in FY 2003 and $100.06 M in FY 2004.

This is composed of estimated expenditure reductions totaling $413.7 M in FY 2003. Estimated revenue increases total $0.06 M in FY 2003 and $100.06 M in FY 2004. The fiscal impact of each provision is summarized in the table; additional details of the bill follow the table.

Expenditure and Revenue Impacts to the State General Fund -- Budget Deficit Reduction Provisions			
Provision	**FY 2002**	**FY 2003**	**FY 2004**
State Expenditures:			
General Fund Construction	--	($32.0 M)	--
Higher Ed Repair & Rehab Expenses	--	(16.3 M)	--
Medicaid Spending	--	(250.0 M)	Indet.
School Funding Provisions	--	(115.4 M)	--
Total Change in Expenditures		($413.7 M)	–
State Revenues:			
BIF Transfer - Lottery/Gaming Surplus	--	--	$100.0 M
Continuing Education Fees		.02	.02
Property Tax Representative Lic. Fee		.04	.04
State Police Fees *	–	Indet.	Indet.
Total Change in Revenues	--	$.06 M	$100.06 M
* The bill provides that the State Police may increase fees by rule and, thus, would depend upon administrative action.			

Tax Restructuring Provisions:

Business Personal Property Tax Refund: Beginning in CY 2004, this provision would provide a refund of 75% of the business personal property taxes (including taxes on depreciable assets and inventory) paid by non-utility business taxpayers in the previous year. Each year, the total of all credits would be limited to the amount of money available in the Business Account of the Property Tax Replacement Fund. Each taxpayer's refund would also be limited to no more than 102% of the taxpayer's previous year refund. The 102% limit is appealable to the Local Government Tax Control Board and the Department of Local Government Finance if the taxpayer has experienced an increase in AV due to increased economic activity by the taxpayer.

Estimation Issues: In estimating the impact of this provision, special attention was given to the impending real property reassessment. The new rules on real property assessment will have a direct impact on property tax rates and the amount of the property tax levy that will be attributed to personal property. According to the bill, personal property will be assessed according to the rules in place in 2001 and not based on the newly promulgated personal property and utility property rules. The real property reassessment will shift some of the property tax burden from personal property owners to real property owners. The total increase in assessed value for 2002 pay 2003 is estimated at about 50.5%, taking the new real property assessment rule into account.

Data: According to the State Tax Board's Property Tax Analysis for various years, the net property tax on non-utility personal property equaled $1.19 B in CY 2000 and $1.22 B in CY 2001. The 2000 pay 2001 personal property AV was $13.8 B and has grown at an average annual rate of 4.6% over the last five years. The estimated gross property tax on non-utility personal property equaled $1.39 B in CY 2000 and $1.42 B in CY 2001. The statewide gross average property tax rate was $10.1672 per $100 AV in CY 2000 and $10.2967 per $100 AV in CY 2001.

Fiscal Impact: Future inventory assessed values were projected based on historical data. Future average gross property tax rates were estimated based on historical data, the credit for school general fund levies found elsewhere in this bill, and on the estimated changes to the total tax base due to the newly adopted real property assessment rule. Based on estimates of future total tax levies and total assessed values, it is estimated that the statewide average gross tax rate will grow at a rate of about 1.7% to 1.8% per year in non-reassessment years. An estimate of the future gross property tax on personal property was computed by multiplying the estimated net assessed value of personal property by the estimated gross average tax rates.

The table below shows the estimated cost to the state to provide the 75% personal property credit beginning in FY 2004.

Estimated State Cost of 75% Business Personal Property Tax Refund		
Property Tax Paid in Calendar Year	**Refund in Fiscal Year**	**Refund Amount**
CY 2003	FY 2004	$ 584.6 M
CY 2004	FY 2005	596.3 M

Homestead Credit Increase: Currently, Homestead Credits are equal to 10% of homeowners' property tax liability. The Homestead Credit percentage is scheduled to change to 4% in CY 2004. This provision would permanently set the Homestead Credit at 10% beginning in CY 2004. In CY 2001, Homestead Credits (at 10%) amounted to $195.5 M.

In addition to the increase in the Homestead Credit rate, the 100% credit for school general fund levies and the revisions to PTRC found elsewhere in this bill will also have an impact in the cost of providing Homestead Credits. Under the bill, homestead credit would be applied *after* PTRC credits have been applied. The following table summarizes all of the changes in this bill that affect the cost of the Homestead Credit. The school general fund credits and PTRC changes were considered first. The resulting Homestead Credit cost serves as the base for the change in the credit percentage.

Summary of Homestead Credit Cost Change					
Cal. Year	**Current %**	**New %**	**Cost Change From School G.F. Credit / PTRC Change**	**Cost Change From Percentage Change**	**Total Cost Change**
2003	10%	10%	($85.4 M)	$ 0	($85.4 M)
2004	4%	10%	(36.1 M)	104.2 M	68.1 M
2005	4%	10%	(38.2 M)	110.2 M	72.0 M

The following table is a summary of the total Homestead Credit cost changes by state fiscal year.

Summary of Homestead Credit Cost Change	
Fiscal Year	**Total Cost Change**
2003	($42.7 M)
2004	(8.7 M)
2005	70.1 M

Property Tax Replacement Credit: Under current law, the state pays Property Tax Replacement Credits (PTRC) in the amount of 20% on most school and civil taxing unit operating fund levies. PTRC is currently paid from the Property Tax Replacement Fund, which is annually supplemented by the state General Fund.

Under this proposal, business personal property would no longer qualify for PTRC payments beginning in CY 2003. Real property, mobile homes, and non-business personal property would continue to qualify for PTRC payments and the PTRC rate would be increased from 20% to 39%. However, PTRC paid on utility real property would continue to be paid at 20%. The PTRC expense was $886.5 M in CY 2001 and has grown at an average annual rate of 4.3% over the last five years.

In addition to the PTRC rate change and the change in property types that qualify for the credit, the 100% credit for school general fund levies found elsewhere in this bill will also have an impact in the cost of providing Property Tax Replacement Credits. The following table contrasts the cost of PTRC under current law and under the proposal.

Summary of PTRC Cost					
Cal. Year	**Current %**	**New %**	**Cost of PTRC under Current Law**	**Cost of PTRC under Proposal**	**Total Cost Change**
2003	20%	39% *	$949.9 M	$935.3 M	($14.6 M)
2004	20%	39% *	975.5 M	960.5 M	(15.0 M)
2005	20%	39% *	1,001.8 M	986.5 M	(15.3 M)
* PTRC on utility real property will be paid at 20% rate.					

The following table is a summary of the total PTRC cost changes by state fiscal year.

Summary of PTRC Cost Change	
Fiscal Year	**Total Cost Change**
2003	($7.3 M)
2004	(14.8 M)
2005	(15.1 M)

Property Tax Replacement Fund: This bill would create six accounts within the Property Tax Replacement

Fund (PTRF), including the School, Business, Residential, Education Rainy Day, Interest, and County Treasurer Distribution Accounts.

School Account: Revenues to this account include 66.667% of Sales Tax collections and 5.5% of the Individual Adjusted Gross Income Tax receipts. Deposits that are not directed to a specific account by law would also be deposited into the School Account. Money in the this account would be used to pay tuition support.

Business Account: Revenues to this account include Business Supplemental Tax receipts, Employer Payroll Expense Tax receipts, 22% of Corporate Gross Income Tax receipts, and 22% of Corporate Adjusted Gross Income Tax receipts. Money in the Business Account would be used for the portion of the 39% PTRC and the school general fund credit attributable to business property, and to fund the Business Personal Property Tax Refund.

Residential Account: Revenues to this account include 13% of Corporate Gross Income Tax receipts, 13% of Corporate Adjusted Gross Income Tax receipts, 70.33% of Cigarette Tax receipts, 2.5% of the Riverboat Wagering Tax and $1 of Riverboat Admissions Tax for each admission. The residential account would be used to pay the portion of the 39% PTRC and the school general fund credit attributable to non-commercial residential property and to pay for Homestead Credits.

Education Rainy Day Account: This account would receive funds from the School Account that are deemed to be not needed to make tuition support payments in the following year. The money is to be reserved in the account until used for tuition support if state revenues fail to meet forecast revenues or during other financial emergencies declared by law.

Interest Account: Interest earned on money in the PTRF would be deposited into this account which could be used to make distributions or pay refunds if insufficient money is available in the Business or Residential Accounts to make required payments.

County Treasurer Distribution Account: This account is used as a clearing account where money from the other accounts is transferred for distribution to local government and schools. The bill moves an appropriation of $1.157 B from the PTRF to this account.

PTRF Distributions: The state currently makes six Property Tax Replacement Credit distributions to county treasurers each calendar year from the Property Tax Replacement Fund. Under HEA 1001 (2001), the May 2001 distribution was delayed until July 2001. After 2001, the original payment schedule is to be resumed. This means that the last FY 2001 payment was delayed until FY 2002 thereby creating five payments in FY 2001 and seven payments in FY 2002. This bill would require that the alternative schedule is to be used each year. The continued delay of the May payment until July would reduce the number of payments in FY 2002 from seven to six.

School General Fund PTRF Credit. The bill increases the current 20% state property tax replacement credit on school general fund levies to 100%. The school formula and school budget process remain unchanged. The school general property tax levies that would be eligible for the 100% credit are estimated to be $1,778.2 M for CY 2003. No school formula currently exists for CY 2004. Assuming a 2.7% annual increase in levies, the levies eligible for the 100% credit would be $1,826.2M in CY 2004 and $1,875.5 M in CY 2005. The expenditures from the School Account in the Property Tax Replacement Fund for FY 2003 is about $889.1 M, ½ of the CY 2003 eligible levy, $1,802.2M for FY 2004 and $1,850.9 M for FY 2005.

School Transportation Levy: The bill changes the growth quotient used in the determination of the maximum transportation levy from the average growth in assessed valuation over three years (with a minimum growth of 5% and a maximum growth of 10%) to the average increase in Indiana personal income over 6 years. The new rate of growth would be about 5.06%. The growth in levies over the last 5 years has been 5.8%. The bill would lower the transportation fund maximum levies by $2.3 M for CY 2003, $4.9 M for CY 2004, and $7.8 M for CY 2005. The state savings in property tax replacement credits (@ 39%) would be $457,000 for FY 2003, $1.4 M for FY 2004, and $2.5 M for FY 2005.

State Spending Cap: This bill establishes a maximum annual percentage change for state government expenditures to be based on the percentage change in Indiana personal income over the last six calendar years. The bill excludes expenditures of revenue derived from gifts, federal funds, dedicated funds, intergovernmental transfers, damage awards, or property sales. Expenditures from transfers of funds between the General Fund, the PTRF and Rainy Day Fund, reserve fund deposits, refunds of intergovernmental transfers, state capital projects, judgements or settlements, distributions of specified state tax revenues to local units, and motor vehicle excise tax replacement payments are also exempt from the expenditure limits. The expenditure limit is applied to appropriations from the General Fund, the Property Tax Replacement Fund, and the Counter-Cyclical Revenue and Economic Stabilization Fund (Rainy Day Fund).

The General Assembly may authorize spending that exceeds the expenditure limit only if specified language is included in the appropriation. The House and Senate are encouraged to adopt rules that would only permit the consideration or adoption of a bill, committee report, or conference committee report that increases, decreases, or exempts expenditures from the cap, if there is a simple majority vote from members of the chamber.

The bill directs the Budget Agency to compute the new state spending growth quotient before December 31 in each even-numbered year. The state spending growth quotient is equal to the lesser of the six-year average increase in Indiana personal income or 6%. The bill allows the state spending cap to be increased or decreased to account for new or reduced taxes, fees, exemptions, deductions, or credits adopted after June 30, 2002.

This bill applies to appropriations beginning in FY 2004. The bill limits expenditure increases to 4% annually for FY 2004 and FY 2005. The new formula for expenditure limits would take effect beginning FY 2006.

The FY 2004 expenditure limit is equal to FY 2002 net expenditures multiplied by 1.04. According to the November 14, 2001, Surplus Statement, FY 2002 budgeted appropriations are $10,211.9 M and net expenditures are estimated to be $9,608.1 M. This would result in approximately a $9,992.4 M expenditure limit for FY 2004 and $10,392.1 M in FY 2005.

Background Information: The average annual change in the six-year average of Indiana personal income (CY 1995 to CY 2000) has been approximately 5.06%. The average annual change in the Indiana personal income for each of the previous six years is identified below.

Calendar Year	Avg Annual % Change in IN Personal Income
1995	4.1%
1996	5.0%
1997	4.9%
1998	7.2%
1999	3.9%
2000	5.3%

Earned Income Tax Credit Refunds: The refundable portion of the Earned Income Tax Credit (EITC) qualifies as Maintenance of Effort (MOE) expenditures and would contribute toward the state's annual MOE requirement under the Temporary Assistance to Needy Families (TANF) program. Based on data from 1999 tax returns, EITC refunds for those eligible under current law total an estimated $13.8 M. The changes proposed in the bill are estimated to increase the refundable EITC by about $9.5 M annually.

Budget Deficit Reduction Provisions:

Dedicated funds with excess balances: The bill allows the Budget Director to transfer before the end of FY 2003 excess balances in certain dedicated funds. These funds include:

License Branch Fund
Underground Petroleum Storage Tank Excess Liability Fund
Pay Phone Fund
Waste Tire Management Fund
Recycling Promotion Assistance Fund
Financial Responsibility Compliance Verification Fund
Environmental Management Special Fund, and the
Regional Health Care Construction Account.

An estimate of the amount of dedicated monies that the administration would chose to transfer to the General Fund is not available at this time.

General Fund Construction: The bill requires the Budget Agency to identify $32 M in spending reductions of General Fund construction projects, excluding higher education general repair and rehabilitation appropriations, listed in the SECTION 37 of P.L. 291-2001, the budget bill. The amount appropriated for General Fund construction in the budget bill was $228,013,036.

General Repair and Rehabilitation for Higher Education: The bill also requires a reduction of $16,333,093 in the 2001-03 biennial appropriations for general repair and rehabilitation for higher education. The bill specifies that the reduction occur for the FY 2001-02 and is equal to 50% of the appropriation for that year.

Interim Study Committee Regarding Muscatatuck: This bill also establishes the Interim Study Committee on Placement of Residents at Muscatatuck State Developmental Center. The purpose of the Committee is to review the placement of residents and the retraining of employees at Muscatatuck. The costs associated with this provision depend upon the number of members on this Committee. Legislative Council Resolution 01-03 established an annual budget of $9,000 for committees up to 15 members and $18,500 for committees of 16 members or greater. This interim study committee expires December 31, 2004, so it can meet during three fiscal years (FY 2002 to FY 2004).

Medicaid Program: The bill directs the Office of Medicaid Policy and Planning (OMPP) to implement measures to reduce General Fund expenditures by $250 M during the current biennium (FY 2002 and FY 2003). The bill specifies that program savings may include, but are not limited to, reductions in expenditures for long term care, pharmacy, acute care, and managed care. Total General Fund appropriations for Medicaid are $2,419,751,412 for the biennium. (This includes amounts for OMPP administration, current obligations, Medicaid administration, and disability eligibility exams.) Assuming that a $250 M reduction in expenditures is realized, the reduction would represent a 10.3% reduction from current appropriation levels for the Medicaid program. A $250 M reduction in the state share of Medicaid expenditures represents a reduction in total Medicaid expenditures, state and federal, of about $658 M.

The bill also provides for specific changes to the Medicaid program, including: (1) eliminating chiropractic services for children under Medicaid and the Children's Health Insurance Program (CHIP); (2) allowing the OMPP to limit: (a) chiropractic services for adult Medicaid recipients; and (b) the amount spent on dental services for Medicaid recipients; (3) authorizing OMPP to require a Medicaid recipient to select only one pharmacy; (4) requiring OMPP to apply for a waiver to include the aged, blind, and disabled in the Medicaid managed care program and excluding these recipients from mandatory participation in the Risk-Based Managed Care program in certain counties; and (5) eliminating continuous eligibility for children in the Medicaid and CHIP programs. The quantifiable impacts to the state from these specified changes are summarized in the following table. (These expenditure reductions from the specified provisions are assumed to be part of the required $250 M expenditure reduction for FY 2002 and FY 2003.)

Impact of Medicaid Changes on General Fund	**Total**	**State**	**Federal**
Expenditures ($M):			
Elimination of Chiropractic Services	(1.6)	(0.6)	(1.0)
Limit Adult Dental Services	(26.3)	(10.0)	(16.3)
Pharmacy “Lock-in”	(35.5)	(13.5)	(22.0)
Elimination of “Continuous Eligibility”	(21.1)	(8.0)	(13.1)
Total Impact on General Fund	(84.5)	**(32.1)**	(52.4)

Rural Development Administration Fund: The bill establishes the Rural Development Administration Fund for the purpose of enhancing and developing rural communities. The Fund is to be administered by the Rural Development Council, and money in the Fund does not revert to the state General Fund at the end of a state fiscal year.

The Rural Development Administration Advisory Board is also established by the bill for the purpose of making recommendations concerning the expenditure of money from the Fund. The 16-member Board consists of 11 voting members and 5 non-voting members, 4 of whom are state legislators. The state legislators on the Board are assumed to be eligible to receive per diem and mileage reimbursement provided to other members of legislative study committees. The per diem and mileage reimbursement would be paid from funds appropriated to the Legislative Council or Legislative Services Agency.

School Funding: The bill reduces the tuition support local schools receive from the state for the last six months of CY 2002 and the first six months of CY 2003. The amount of the reduction each year is the CY 2002 assessed valuation divided by 100 times the lesser of $0.0328 or ½ of the CY 2002 capital projects fund rate. The reduction would be about $57.7 M per six-month period, or $115.4 M for FY 2003.

Explanation of State Revenues: (Revised) ***Tax Restructuring Provisions:***

Business Supplemental Tax: This bill also imposes a Business Supplemental Tax based on Indiana adjusted gross income (AGI) on all legal entities doing business in Indiana. Entities include corporations, S corporations, partnerships, limited partnerships, limited liability partnerships, limited liability companies, and business trusts. The term "legal entities" for tax purposes excludes sole proprietorships. The tax rate is the greater of $400 or 1% of AGI.

Methodology: The estimate of revenue received from a Business Supplemental Tax is based on data from the Department of State Revenue corporate tax returns and the federal Internal Revenue Service individual income tax returns for Indiana. This methodology yields a forecast of $158.6 M for CY 2003, which is estimated to grow at the same rate as other business income, 3% per year.

It is estimated that approximately 95% of corporate tax payers will have a liability under the $1,050 threshold for quarterly filing requirements. Therefore, it is estimated that approximately $63.4 M will be remitted in FY 2003, $160.5 M in FY 2004, and $165.3 M in FY 2005.

The revenue from this tax is to be deposited in the Business Account of the Property Tax Replacement Fund.

Cigarette Taxes: This bill increases the Cigarette Tax on packs of 20 cigarettes to $0.55 from the current rate of $0.155 (the bill does not increase the tax on other tobacco products). Based on data from the November 14, 2001, state revenue forecast, it is estimated that the proposed Cigarette Tax rate increase will generate an additional $262.8 M in FY 2003, $287.4 M in FY 2004, and $288.8 M in FY 2005. Although the effective date of this proposal is July 1, 2002, cigarette taxes at the $0.55 rate would not be remitted until August 2002. Therefore, the estimate for FY 2003 only includes revenue from 11 of the 12 months in which the increase is in effect during FY 2003.

The bill also adjusts the statutory percentage distribution of Cigarette Tax revenue so that the increased revenue will be distributed to the Residential Account of the Property Tax Replacement Fund. Distributions to the state General Fund, the Cigarette Tax Fund, the Mental Health Centers Fund, and the Pension Relief Fund were adjusted so that the funds would continue to be funded at current levels.

Corporate Taxes: This bill eliminates the Supplemental Net Income Tax and establishes a Corporate Adjusted Gross Income Tax at a rate of 8.5% applied to apportioned Indiana AGI.

Background: Currently the Corporate Gross Income Tax applies to regular corporations who must compute their gross tax liability and their adjusted gross tax liability and pay the greater of the two. A corporation must then subtract that liability from apportioned Indiana adjusted gross income (AGI) and pay Supplemental Net Income Tax (SNIT) at a rate of 4.5% on that tax base. The effective tax rate for a taxpayer paying Adjusted Gross Income Tax and Supplemental Net Income Tax is 7.747%.

Methodology: Increasing the tax rate from an effective rate of 7.747% to 8.5% on apportioned Indiana AGI is effective for taxable years beginning after December 31, 2002. Therefore, it would take effect mid-way through state FY 2003. If corporations make adjusted tax payments immediately, the impact is estimated to be an additional $37.9 M in FY 2003. Adjusted Gross Income Tax revenue collections would increase by an additional $80.0 M in FY 2004 and $84.4 M in FY 2005.

Distribution of Corporate Tax Revenue: The bill changes the distribution of the Corporate Gross Income Tax and Adjusted Gross Income Tax so that 65% of the revenue is deposited in the General Fund, 13% is deposited in the Residential Account of the Property Tax Replacement Fund (PTRF) and 22% is deposited in the Business Account of the PTRF. (Currently 100% of the corporate Gross Income Tax is deposited in the General Fund, and Corporate AGI is deposited in both the General Fund and the PTRF.)

Employer Payroll Expense Tax: The bill establishes a payroll tax equal to 0.75% of compensation paid by private employers to one or more employees who are Indiana residents or who perform work or render services in whole or in part in Indiana. Under the bill, the tax is imposed on employer payrolls effective January 1, 2003. The payroll tax is estimated to generate $276.0 M in FY 2003; $561.4 M in FY 2004; and $580.4 M in FY 2005. The bill requires revenue from the payroll tax to be deposited in the Business Account of the Property Tax Replacement Fund. The bill exempts from payment of the tax: (1) federal, state, and local government entities and instrumentalities; (2) nonprofit organizations that are exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code; (3) private educational institutions; (4) entities organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes if no part of the such an entity's income is used for the private benefit or gain of any member, trustee, shareholder, employee, or associate of the entity; and (5) sole proprietors who have no employees.

The revenue estimates are based on 1999 federal income tax data on wages, salaries, and other compensation paid to Indiana filers totaling $86.1 billion. Estimates of federal government, local government, and pertinent nonprofit payrolls, and payroll totals for state government, state higher education institutions, and school corporations were subtracted from this total. After adjustments to reflect annual growth in compensation, 2003 base-year net private payroll in Indiana is estimated to total approximately $73.6 billion. Estimated totals in subsequent years assume 3.4% annual growth.

Earned Income Tax Credit: The bill increases the Earned Income Tax Credit (EITC) and expands the coverage of the credit effective January 1, 2003. Under the bill, the EITC expires on December 31, 2005, so these changes would be effective for tax years 2003, 2004, and 2005. The current EITC law is scheduled to expire on December 31, 2003. The changes made by the bill are estimated to increase the annual cost of the EITC by approximately $14.3 M above the cost of the current EITC.

Under current law, a taxpayer may claim the EITC if: (1) the taxpayer has at least one qualifying child; (2) the taxpayer's income from all sources does not exceed $12,000; and (3) at least 80% of the taxpayer's Indiana total income is earned income. The amount of this refundable credit is equal to:

($12,000 - the taxpayer's Indiana total income) x (the AGI tax rate of 3.4%).

The bill changes the maximum income level from $12,000 to $15,000, and, in tandem with the individual AGI tax rate increase discussed above, increases the rate at which the EITC is computed to 3.6%. Both of these changes will increase the credit amount made available to current EITC recipients. In addition, the increase in the income level will extend the credit to taxpayers whose income from all sources is between $12,000 and $15,000. Simulations using 1999 individual income tax records suggest that about 105,000 taxpayers are eligible to claim credits under the current EITC totaling approximately $17.5 M annually. Simulations for taxpayers with Indiana total income up to $15,000 and a qualifying child suggest that the additional cost will total $14.3 M annually. These simulations also account for the change in the tax rate to 3.6%. (Based on adjustments to withholdings, the estimated additional revenue loss in FY 2003 would be approximately $6.0 M.)

Individual AGI Tax Rate Increase: The bill increases state AGI tax rate from 3.4% to 3.6% on all taxable adjusted gross income effective January 1, 2003. The rate increase is estimated to increase AGI Tax revenue by approximately $87.4 M in FY 2003; $234.6 M in FY 2004; and $242.6 M in FY 2005. These totals are based on the updated FY 2003 individual AGI Tax forecast of $3,857.0 M assuming 3.4% annual revenue growth in FY 2004 and FY 2005. (This is equal to the forecast revenue growth for FY 2003.) The FY 2003 total also assumes that the tax rate change will impact monthly withholding and quarterly estimated tax payments during the second half of that fiscal year. Some employers and tax payers may not make these adjustments on time to accurately reflect the tax change beginning January 1, 2003.

Personal Property Tax Credit: This bill would repeal the existing $37,500 AV credit against state tax liability for personal property (PPTRC). The cost of the credit under current law is estimated at $96.0 M in FY 2004 and $97.9 M in FY 2005. The state would not experience this revenue reduction under the proposal.

Research Expense Credit: This bill increases the credit from 5% to 10% for tax years beginning January 1, 2003, and eliminates the apportionment factor. This bill also extends the credit until December 31, 2004. It is currently set to expire December 31, 2002. This will continue the base impact of this credit in FY 2004 and FY 2005.

It is estimated that eliminating the apportionment factor and the 5% increase will result in an additional revenue loss over the current base ranging from $12.1 M to $23.0 M in FY 2003 (due to changes in estimated quarterly payments), $24.8 M to $47.9 M in FY 2004, and $26.2 M to $51.5 M in FY 2005.

In FY 1999 approximately $24.2 M in Research Expense Credits were taken. It is difficult to estimate the exact impact of continuing this tax credit since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability.

Apportionment Provision: This modification would mean that the credit is based on the taxpayer's Indiana qualified research expenses, rather than the lesser of its Indiana qualified research expenses or its apportioned research expenses for the tax year beginning January 1, 2004. Currently, only businesses that do not have income apportioned to the state for a taxable year may calculate their credit based on only Indiana research expenses.

This change would lower the tax liability for multi-state, Indiana-domiciled companies that conduct a significant proportion of their research in Indiana, compared to the research conducted through their non-Indiana operations. Elimination of the apportionment factor will allow all companies to compute their tax credit based on the amount of research actually conducted in the state. It is unknown how many Indiana businesses would be affected by this change.

With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

Research Expense Tax Credit affects revenue collections deposited in the General Fund.

Riverboat Admission Tax Increase: The bill increases the Riverboat Admission Tax from $3 to $4 effective July 1, 2002. The bill requires the revenue from the additional $1 Admission Tax to be distributed to the Residential Account of the Property Tax Replacement Fund. The additional $1 Admission Tax is estimated to produce approximately $41.7 M in FY 2003; $42.5 M in FY 2004; and $43.4 M in FY 2005.

Under current statute, a $3 Admission Tax is imposed on the owner of each riverboat casino in Indiana. The tax must be paid for each person admitted to a riverboat gaming excursion, whether paid or unpaid. Approximately 39.5 M riverboat admissions resulted in just over $118.6 M in revenue from the current $3 Admission Tax during FY 2001. During the 12-month period November 2000 to October 2001, however, admissions to the riverboats totaled approximately 40.4 M. Assuming annual growth rates based on recent admission trends equal to 1.1% and 3%, admissions are estimated to range from 41.1 M to 42.2 M in FY 2003; 41.5 M to 43.5 M in FY 2004; and 42.0 M to 44.8 M in FY 2005. The estimated revenue totals above are based on the midpoint of these admission ranges.

Riverboat Wagering Tax Increase: The bill increases the Riverboat Wagering Tax to 22.5% on the annual adjusted gross wagering receipts (AGR) generated by a riverboat casino effective July 1, 2002. The bill requires the incremental revenue due to the increase in tax rate from 20% to 22.5% to be distributed to the Residential Account of the Property Tax Replacement Fund. The rate increase is estimated to generate approximately $46.3 M in FY 2003; $47.9 M in FY 2004; and $49.6 M in FY 2005. This estimate is derived using the State Budget Agency's FY 2003 forecast (as of January 22, 2001) of Wagering Tax revenue totaling $370.16 M and assumes 3.5% annual growth in AGR based on recent trends.

Sales & Use Tax: This bill increases the Sales and Use Tax from 5% to 6% effective January 1, 2003. The bill also makes changes in the manner in which Sales and Use Tax revenue is distributed, so that approximately two-thirds of all Sales Tax revenue is distributed to the School Account of the Property Tax Replacement Fund, while the remaining third is distributed among the state General Fund, the Public Mass Transportation Fund, the Commuter Rail Service Fund, and the Industrial Rail Service Fund.

The rate increase is estimated to generate approximately $327.5 in FY 2003, $806.4 M in FY 2004, and $827.4 in FY 2005 in increased Sales Tax revenue. This estimate assumes that the Sales Tax revenue will grow 2.6% annually. (This is the same rate forecast for FY 2002 by the Revenue Technical Committee on November 14, 2001.) The estimate for FY 2003 assumes increased Sales Tax revenue from only 5 of the 6 months in which the increase is in effect during FY 2003 because of the timing of remittance and posting of Sales Tax revenue.

The bill also changes the distribution of Sales Tax revenue. Under current law, Sales and Use Taxes are deposited in the state General Fund (59.03%), the Property Tax Replacement Fund (40%), the Public Mass Transportation Fund (0.76%), the Commuter Rail Service Fund (0.17%), and the Industrial Rail Service Fund (0.04%). This bill changes the distribution to the following: the School Account of the Property Tax Replacement Fund (66.667%), the state General Fund (32.525%), the Public Mass Transportation Fund (0.633%), the Commuter Rail Service Fund (0.142%), and the Industrial Rail Service Fund (0.033%). The distributions to the Public Mass Transportation Fund, the Commuter Rail Service Fund, and the Industrial Rail Service Fund were adjusted so that the dollar amount of funding would remain at current levels.

Budget Deficit Reduction Provisions:

BIF Appropriation to the State General Fund: The bill provides an annual appropriation of $100 M from the Build Indiana Fund (BIF) to the state General Fund, beginning in FY 2004. Sufficient revenue is expected to be available for the $100 M appropriation in FY 2004 (as specified in the table below). This is based on the current State Budget Agency forecast for the BIF in FY 2003 and assumes that revenue to the BIF in FY 2004 will not change. The appropriation will reduce the amount available to the State and Local Capital Projects Account (SLCPA) in the BIF in FY 2004 from an estimated $169.0 M to $69.0 M.

Surplus Lottery and Gaming Revenue to BIF (Millions)*

Revenues & Distributions	**FY 2001 (Actual)**	**FY 2002 (Projected)**	**FY 2003 (Projected)**	**FY 2004 (Projected)**
Surplus Lottery Revenue	$160.0	$155.0	$155.0	$155.0
TRF Transfer	($30.0)	($30.0)	($30.0)	($30.0)
PRF Transfer	($30.0)	($30.0)	($30.0)	($30.0)
Surplus Lottery Revenue to LGSA	$100.0	$95.0	$95.0	$95.0
Surplus Gaming Revenue to LGSA	$268.2	$285.2	$285.2	$285.2
Interest	$26.9	$25.0	$25.0	$25.0
Total Revenue to BIF	$395.1	$405.2	$405.2	$405.2
Appropriation to State Gen. Fund	$0	$0	$0	($100.0)
MVETRA Transfer	($234.7)	($236.2)	($236.2)	($236.2)
SLCPA Transfer	($160.4)	($169.0)	($169.0)	($69.0)

*Updated as of 10/25/01.

Under current statute, (1) surplus Lottery revenue net of transfers to the Teachers' Retirement Fund (TRF) and the Pension Relief Fund (PRF); and (2) surplus gaming revenue (revenues from the Riverboat Wagering Tax, the Pari-mutuel Wagering Tax, the Pari-mutuel Satellite Facility Tax, the Charity Gaming Excise Tax, and the Charity Gaming License Fee) is distributed to the Lottery and Gaming Surplus Account (LGSA) within the BIF. A statutorily determined amount of revenue in the LGSA is transferred each year to the Motor Vehicle Excise Tax Replacement Account (MVETRA) within the state General Fund. (Beginning with FY 2002 and continuing each year thereafter, this amount is equal to approximately $236.2 M.) The remaining money in the LGSA is then transferred to the SLCPA. The balance in the BIF as of June 30, 2001, was $347.3 M. After statutorily required transfers and appropriations under HEA 1001-2001, the balance in the BIF as of June 30, 2002, is expected to total $154.7 M; and as of June 30, 2003, is expected to total $8.0 M.

Non-Governmental Employee Continuing Education Fee: Under current law, the Department of Local Government Finance (DLGF; formerly the State Tax Board) must conduct a minimum of four continuing education sessions each year for the benefit of local assessing officials. This bill would require an individual who is not a local assessing official or their employee or an employee of the DLGF who attends a session to pay a fee. The fee would equal $50 for a half-day session or $100 for a full day. According to the State Tax Board, an average of 57 non-government individuals attend each of the four full-day sessions annually. Assuming continued attendance, the fee imposed under this provision would generate about $23,000 per year from these individuals beginning in FY 2003. The fees would be deposited into the Assessing Official Training Account of the state General Fund.

Property Tax Representative Licensing Fee: Under current law, the DLGF must adopt rules that govern the practice of tax representatives before the Indiana Board and the DLGF. As part of those rules, this bill would require the DLGF to establish a licensing program for tax representatives. A license applicant or license holder would be required to pay an annual fee up to $50, which would be deposited into the state General Fund. The license and the associated fee would not apply to the property owner, full-time employees of the property owner, representatives of local taxing units, CPAs, or attorneys because they are not considered to be tax representatives under the current rule.

According to the State Tax Board, there are currently between 500 and 1,000 tax representatives in the state who would be subject to the license program. A $50 annual license fee imposed by this provision would generate approximately $25,000 to $50,000 annually beginning in FY 2003.

State Police Fees: (A) For supplying copies of accident reports, the State Police Department currently charges $3 for each report. The bill provides that the Department may, by rule, charge a fee in an amount greater than $3 for each report. This fee is deposited in the “accident report account.” The fee generated about $108,000 under the current fee structure in FY 2001. (B) Under IC 20-9.1-4-5, the State Police Department is required to inspect all special purpose, and public and private school buses that transport its pupils. The bill authorizes the State Police Department to impose fees for those inspections. In FY 2000, the Department completed 13,947 school bus inspections, 2,121 random or spot inspections, and 647 twelve-year-old or older school bus inspections. In addition, the Department made 450 to 500 special purpose bus inspections. This bill authorizes the State Police Department to impose fees for these inspections. (C) Current statute also provides for the collection of a $3 fee to defray the cost of processing a request for inspection of a limited criminal history and $7 to defray the cost of processing a request for release of a limited criminal history. This bill allows the State Police to increase the level of fees by rule. This fee generated about $1.753 M in FY 2001 under the current fee structure. The additional revenues from these provisions will depend upon administrative action.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised)

Business Personal Property Tax Credit: This provision would not affect local revenues. Non-utility business property owners would continue to pay their property tax bills and then would receive refund checks from the state.

Homestead Credit Increase: The increase in Homestead Credits would not affect local revenues. Homeowners’ property tax bills would be reduced by the additional credits, but the state would reimburse local taxing units for the lost revenue.

Local Option Income Tax Distributions: Under current law, counties that impose the County Option Income Tax (COIT) may provide a locally funded Homestead Credit up to an additional 8%. COIT revenue that is not used to fund the local Homestead Credit is distributed to civil taxing units (counties, townships, cities, towns, libraries, and special taxing units). A reduction in the net property tax levy would reduce the cost of providing the local Homestead Credit, thereby directing more COIT revenue to civil taxing units.

Maximum Levy Increases: Under current law, a civil taxing unit’s maximum permissible levy increases at the rate of the unit’s AV growth with a 5% minimum and a 10% maximum. This is the unit’s assessed value growth quotient, or AVGQ. The bill would allow maximum levies to increase by the 6-year average annual growth in Indiana personal income (IPI) , as calculated by the U.S. Bureau of Economic Analysis, with a 6% maximum. The change in IPI over the last six years (1995-2000) has averaged about 5.06% which is virtually the same as the current minimum 5% change. For those units with an AVGQ greater than 5% (479 of 2,122), the average CY 2002 growth rate was 8.8%. Many of these units could qualify to seek an increase in their maximum levy through the appeal process described below.

Under current law, a civil unit may appeal to the state's Local Government Tax Control Board for an increase in its maximum levy if the unit's AVGQ is greater than 1.1. The Control Board considers the appeal and sets the increase based on the merits of the appeal. The maximum levy increase may not exceed the unit's AVGQ. This bill would also allow an appeal. A unit could appeal if it's AVGQ exceeds the statewide average AVGQ by at least 3%. The Control Board would still consider the appeal on the its merits, but it would not be limited in setting the maximum levy.

Overall, this provision would not have much impact on civil unit maximum levies. This new maximum levy formula will simplify maximum levy calculations beginning in 2006, when annual assessment adjustments are scheduled to begin.

Personal Property Rules: The Department of Local Government Finance has promulgated new rules governing the assessment of business and utility personal property. These new rules along with their new valuation schedules are set to go into effect for property assessed on the March 1, 2002, assessment date with taxes paid in CY 2003. On average, theses rules would have raised business personal property assessments by 34.3% and reduced utility personal property assessments by 5%. This bill would negate the new rules and require personal property to be assessed under the rules in place on January 1, 2001. Personal property taxpayers who already have filed their March 1, 2002, return would be required to file an amended return, reflecting the old rules.

The overall effect of using both the old business and old utility personal property rules would be a reduction of the expected AV base. This AV reduction would cause an increase in the property tax rates. These rates were used in all of the estimates made elsewhere in this note.

Property Tax Replacement Credit: Total local revenues would not be affected by the change to PTRC. Taxpayers' property tax bills would be reduced by the additional credits, but the state would reimburse local taxing units for the lost revenue.

School General Fund Property Tax Levies: Gross school general fund tax levies would not be affected by this proposal. Instead, the state would pay a 100% credit from the School Account of the PTRF. Since gross levies and gross rates are not affected, there would be no change in the distribution of miscellaneous revenues including Excise Tax, Financial Institutions Tax, and local property tax relief credits from CAGIT proceeds.

School Referendum Tax Levies: Currently, an approved referendum provides a permanent increase to a school's general fund levy. The amount of the referendum is excluded from the tuition support formula calculation the first and second years the increase is imposed. In latter years the referendum is treated the same as other general fund levy increases and is included in expenditure and taxpayer equalization calculations. Due to certain provisions in the current school formula, a school that passed a referendum may not be receiving additional revenue generated by the passage of the referendum. A school that receives the foundation grant of $4,440 in CY 2002 and passed a referendum more than two years ago is receiving the same school formula revenue and has the same tax rate as a school that did not pass a referendum.

The bill would create the referendum tax fund and levy. The levy may be imposed for up to seven years and is equal to the amount of referendum approved by the voters. The new levy would be excluded from the tuition support calculations. It is not possible to estimate the number of future referendums or who might pass a referendum.

The exclusion of the referendum levy from the school formula would decrease future school general fund levies and increase state tuition support funding for the school formula. The total property tax levy for schools would be higher since the reduction in the general fund levy would be less than the levy of the referendum tax fund.

The following table lists the number and the dollar amount of levy increases due to approved referendums since 1982.

Calendar Year	Number Approved	Levy
1982	1	$47,000
1985	4	$2,350,034
1986	5	$4,413,281
1987	4	$1,263,000
1988	2	$5,449,875
1997	1	$456,085
1998	1	$150,000

Shelter Allowance / Standard Deduction: Under the new real property assessment rule recently promulgated by the DLGF, homeowners would receive a shelter allowance against the assessment of their principal residence. These allowances vary by county, ranging from $16,000 to $22,700 and averaging $19,000. Under this proposal, the shelter allowance would be replaced by a $19,000 increase in the standard deduction. This deduction would change from $6,000 to $25,000. On a statewide average basis, the $19,000 increase in the standard deduction has the same overall effect as the shelter allowance. However, the effect will vary slightly by county, depending on how the county's shelter allowance compares to the $19,000 standard deduction increase.

State Expenditure Limits: Distributions of state revenue to local units of government are dependent on the disposition of state appropriations.

Tax Increment Financing: Tax increment financing (TIF) allocations are equal to the incremental assessed value in a TIF area multiplied by the surrounding taxing district's tax rate. Since the gross property tax rate will not be reduced by the credits in the bill, TIF districts would not be adversely affected by the proposal.

State Agencies Affected: All.

Local Agencies Affected: All.

Information Sources: GF & PTRF Statement of Combined Estimated Unappropriated Reserve, November 14, 2001 - State Budget Agency; November 14, 2001, State Revenue Forecast- Revenue Forecast Technical Committee; U.S. Census Bureau; Department of Local Government Finance; Local Government Database.